omgeo

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For publication

Dear Sirs

Re: CPSS-IOSCO standards

Omgeo Limited would like to take the opportunity to comment on the consultative report "Principles for financial market infrastructures issued March 2011. In particular we will comment on Annex C – recommendation 2 (page 111) regarding trade confirmation standards.

About Omgeo

Omgeo is a global joint venture equally owned by The Depository Trust & Clearing Corporation (DTCC) and Thomson Reuters. Our principal products are: Omgeo CTM (Central Trade Manager) and Omgeo Alert. For more information go to www.omgeo.com

Omgeo is one of the largest providers of trade confirmation systems globally. Our systems process on-exchange and OTC equity and fixed income trades in domestic and cross-border markets. Our client community includes buy-side firms, broker/dealers and third-party service providers such as prime-brokers, custodian banks, fund-administrators and outsourcers. As of May 1st 2011 Omgeo CTM, our core European product had 611 live clients. Omgeo's global client community exceeds 6,000 firms in 46 countries. Trade volumes from those solutions range between 4.5 and 5 million trades per month.

Executive Summary

The global tend towards shortened settlement cycles, most prominent in Europe, requires all market participants to focus on SDA (Same Day Affirmation) to achieve operational efficiency and reduced risk. Universal adoption of SDA can only be achieved by regulatory mandate.

Same Day Affirmation

Omgeo, and its client community, is highly focussed on the concept of Same Day Affirmation – referred to as "SDA".[1] We define SDA as "the agreement of all trade details on trade date (T+0) between a broker/dealer and an investment manager (or their agent)". The case for SDA is based on the simple premise that by agreeing on the details of a trade more quickly, operational risk, costs and inefficiencies are significantly reduced. If you can lock-in trade details sooner and confirm on trade date, you have more time to identify and resolve any potential errors. Therefore, the chances of a trade failure are reduced. SDA is a vital prerequisite for mitigating operational risk and increasing settlement efficiency. It is also an important prerequisite for achieving shorter settlement cycles.

Omgeo has published two reports on this area: the 2008 Omgeo/Oxera study entitled: **"SDA: Why should Europe care?**" and the 2010 Omgeo analysis entitled: "**Mitigating operational risk and increasing settlement efficiency through same day affirmation**".[2] In the 2008 Omgeo/Oxera study one of the key findings was that firms adopting automated processes to achieve SDA can expect reductions in the risk and costs associated with trade verification and other post-trade processes, including an improved settlement performance

The two research reports mentioned above indicate the following benefits of SDA:

- Securities trades affirmed on the same day have a much higher chance of settling on time and are less likely to fail
- There is a direct correlation between high SDA rates and high settlement rates.
- Countries with SDA rates of over 90 percent – India, Taiwan, Hong Kong, Japan, Singapore and Korea consistently collect the most impressive settlement efficiency scores.
- On the other hand, countries with SDA rates of less than 70 percent – Brazil, Italy, South Africa and the United States consistently collect below-average settlement efficiency scores.
- The analysis showed that there are benefits of a regulatory and industry push to shorten the settlement cycle. Four of the five countries which display the highest SDA rates and highest settlement efficiency scores require T+2 settlement for most securities including India, Taiwan, Hong Kong and Korea. Similarly, South Africa, which has one of the lowest SDA rates and settlement efficiency scores, operates on a T+5 cycle. These data points suggest that countries that have imposed shortened settlement cycles are achieving higher efficiency and lower operational risk than other countries with more relaxed standards.
- Generally speaking, regulatory, cultural and regional workflow practices are the main determinants of SDA rates, with regional regulation being the most important driver. Unless firms are under strict obligations to comply with specific market rules and regulations, it's often very difficult to change and improve historical processing behaviours.

SDA rates achieved by Omgeo CTM clients for May 2011 were as follows: 93.99% on T, 98.78% on T+1, 99.01% on T+2.

[1] Note that SDA is also identified by other terms: Trade Date Matching and Trade Date Confirmation are synonymous with SDA.
[2] Both reports are available at www.omgeo.com

Our submission

Prior to detailed comment we want to acknowledge that the sections referred to have not been updated as part of the recent review.

Recommendation 2 on trade confirmation states: *"Confirmation of trades between direct market participants should occur as soon as possible after trade execution, but no later than trade date (T+0). Where confirmation of trades by indirect market participants (such as institutional investors) is required, it should occur as soon as possible after trade execution, preferably on T+0, but no later than T+1."*

There are several aspects to this statement on which we wish to provide input:

- Reduced settlement periods
  You will be aware that there is a global debate ongoing about the value of reduced settlement periods. It appears very likely that that the European Commission will mandate a T+2 settlement cycle in Europe and this is likely to be implemented prior to the 2014 live-date of Target 2 Securities. Other markets are also reviewing this area. Recommendation 2 clearly assumes a T+3 cycle which appears unlikely to be regarded as the standard cycle in the near future.

  This issue is further affected by the regulatory debate on increased ex-ante and ex-post measures to reduce the number of failed trades. If penalties and costs are to be increased, as seems likely, market standards should aim to encourage processes such as SDA which will reduce settlement failures.

  This issue also directly impacts Recommendation 3 (T+3 settlement) and we suggest that both Recommendations 2 and 3 would benefit from a review.

- The delineation between "direct" and "indirect" market participants
  Recommendation 2 refers to "direct" and "indirect" clients. In very general terms "direct" would normally be interpreted as banks/broker-dealers and "indirect" as buy-side firms/clients.

  Our view, shared by our clients, is that the designation of market participants as "direct" or "indirect" is a legacy concept that is no longer appropriate. It does not reflect the lessons learned in the global financial crisis or the way the market has evolved. Many buy-side firms are highly sophisticated traders with technology and operational skills fully equal to their "sell-side" counterparts. We believe that from a risk and market-stability perspective it does not seem sensible to allow a major market participant to work to a lower standard simply because they are designated as buy-side.

  The "direct" and "indirect" designations also do not reflect the increasing complexity of the markets where prime-brokers and middle-office outsourcers play a prominent role in the transaction lifecycle. Prime-brokers are both direct and indirect participants – they are not involved in the execution of a trade but are responsible for its settlement and therefore have a fiduciary role. Outsourcers are indirect participants – but are normally units of banking organisations which would be normally designated as direct participants.

  Our view is that trade confirmation standards should apply equally to all market participants. In the operation of our trade confirmation systems we do not detect any structural issues that would mean buy-side firms are generically slower or less able than banks/broker-dealers.

- The timing of trade confirmation processing
  Our suggestion, as stated above, is that SDA should be a core market principle for all trades, in all asset classes by all market participants. In a 2 day settlement cycle the T+1 period should be used for resolution of problem trades and not for the general processing cycle. In the Omgeo CTM trade confirmation platform (primarily used for x-border trades in Europe and Asia-Pacific) approximately 70% of all trades are completed within 3 hours.

- The role of indirect market participants
  Recommendation 2 states: “Where confirmation ... by indirect market participants … is required...” This implies that buy-side trades may not always require a confirmation. This is, in fact, a reversal of the normal market practice. The vast majority of trades done between broker-dealers and banks (ie: direct participants) do not require an overt confirmation process. Trades are confirmed either within the automated trading process or via trade instruction to a CCP or a CSD. Buy-side firms (indirect market participants) are generally less automated in their trading activity – meaning a much higher level of telephone orders. Buy-side firms are also not members of CCP’s or CSD’s and cannot therefore use these platforms to perform trade confirmation.

  The normal market practice is for the vast majority of buy-side trades to require a post-trade confirmation process. This requirement is amplified by the market practice of aggregating client orders into block trades and the need to subsequently split a block trade into multiple client accounts (known as allocations) for settlement. Exchanges, CCP’s and CSD’s do not have the functionality, or linkages to the buy-side, to provide this service to buy-side firms.

  Our input therefore is that Recommendation 2 should probably take the opposite perspective – all trades require a confirmation especially if an allocation process is required.

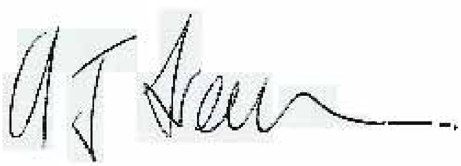
Conclusion

Our conclusions are:

- Recommendations 2 and 3 need to be reviewed in light of the global trend towards shortened settlement cycles for equity and fixed-income
- SDA (Same Day Affirmation) can serve as a key ex-ante measure to achieve operational efficiency and reduced risk
- Historical market behaviour suggests that universal adoption of SDA is most likely via regulatory mandate combined with appropriate ex-post measures or sanctioning regimes.

Please do not hesitate to request clarification on any of the points above. We look forward to further discussions and wish you every success in the project.

Yours faithfully



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Appendix

Key findings of the 2008 Omgeo/Oxera report: "Building Efficiencies in Post-Trade Processing: the benefits of Same Day Affirmation."

1st Key Finding

- Automation & SDA lead to reduced operational risk & improved settlement efficiency
  - settlement failure rates for clients with automated trade verification processes can be 50% lower than for non-automated clients!
  - Direct correlation between SDA, automation and reduced failed trades

2nd Key Finding

- Significantly reduced operating costs through Automation & SDA
  - Automation enables larger volume of trades to be processed without a corresponding increase in costs and risk
    - Firms maintain the same level of staffing in the middle office irrespective of trade volumes
  - SDA enables reduced failed trades & fewer costs downstream

3rd Key Finding

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  - Efficiency gains translate into lower transaction costs for end-investors
  - Reducing risk and costs translate into lower prices and lower transaction costs for end-investors
  - There is a beneficial effect on liquidity

For full content go to http://www.omgeo.com/page/oxera_report

Key findings of the 2010 Omgeo report: "Mitigating operational risk and increasing settlement efficiency through same day affirmation"

- SDA is a critical component for mitigating operational risk and increasing settlement efficiency.
- The direct correlation between high SDA rates and high settlement scores is compelling as data shows that trades affirmed the same day have a much higher chance of settling on time and are less likely to fail.
- Settlement efficiency is 26% higher in countries with SDA rates over 90 percent.
- SDA is an essential building block for successfully moving to shorter settlement cycles.
- Countries which have imposed shortened settlement cycles while embracing SDA are achieving higher settlement efficiency and lower operational risk.
- The industry is engaged and preparing for what many consider the inevitable to further minimize operational risk: a future of shorter settlement cycles facilitated by SDA.

For full content go to http://www.omgeo.com/sda